Q. Further to the response to PUB-NP-032, would any of the credit metrics at the different returns on equity stated in the response be problematic with respect to maintaining Newfoundland Power's credit rating?

A. The maintenance of Newfoundland Power's (the "Company") creditworthiness and its ability to maintain a sound credit rating is not solely a matter of credit metrics.

The Company's credit ratings are determined by both Moody's Investor Services ("Moody's") and DBRS.[1] Newfoundland Power's credit ratings are influenced by a number of factors, including credit metrics, financial metrics such as capital structure, and regulatory considerations such as the regulatory framework and the ability to recover costs and earn returns.[2]

The response to Request for Information PUB-NP-032 shows the *pro forma* credit metrics based on existing customer rates as well as for returns on equity of 8.50% to 9.50%.[3] All scenarios reflect a common equity capital structure of 45%.

Under existing customer rates, the rate of return on common equity is forecast to be 7.04% for 2019 and 6.44% for 2020. These returns are well below current Canadian and U.S. allowed returns for regulated utilities. It is clear that the credit rating agencies which rate Newfoundland Power consider the existing supportive regulatory environment as a credit strength.[4] If the Board were to allow returns on equity well below current North American norms, there is a risk that the credit rating agencies may take a more negative view on the regulatory environment. Further, maintaining existing customer rates results in deteriorating credit metrics for both 2019 and 2020.[5] In the Company's view, maintaining the existing scenario represents a risk to maintaining its existing credit ratings.

Newfoundland Power observes that returns on equity of 8.50% to 9.50% with an equity capitalization of 45% for 2019 and 2020 provide for reasonably stable *pro forma* credit metrics. In the Company's view, this range of returns on equity is not expected to be problematic with respect to maintaining existing credit ratings.

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1 See *Volume 1, Application, Company Evidence & Exhibits*, *Exhibit 4*, for both the Moody's and DBRS credit rating reports.

2 See, for example, page 7 of *Moody's Credit Rating Report* found in *Volume 1, Application, Company Evidence & Exhibits, Exhibit 4.*

3 Existing scenario reflects a return on equity ("ROE") of 7.04% for 2019 and 6.44% for 2020 forecast. See *Volume 1, Section 3: Finance*, *Table 3-15: Comparative Rates of Return*, page 3-34. Each proposed scenario, with ROEs ranging from 8.50% to 9.25% for both 2019 and 2020 *pro forma,* assumes all GRA proposals are approved other than the change in the respective ROE.

4 See *Volume 1, Application, Company Evidence & Exhibits*, *Exhibit 4*, for both the Moody's and DBRS credit rating reports. On page 2 of each agency's report, a supportive regulatory environment is listed as a credit strength.

5 See *Volume 1, Section 3: Finance, Table 3-11: Credit Metrics: 2015 to 2020E,* page 3-12.

While Newfoundland Power expects the range of returns on equity of 8.50% to 9.50% reflecting a common equity ratio of 45% to support existing credit ratings, in determining an appropriate return on equity for the Company, the Board is guided by the fair return standard. In Order No. P.U. 18 (2016), the Board stated:

> "*In Order No. P.U. 43(2009) and in Order No. P.U. 13(2013), its most recent Order on this issue, the Board stated that "to be considered fair the return must be commensurate with the return on investments of similar risk and sufficient to assure financial integrity and to attract necessary capital. This statement, which reflects accepted regulatory principles, concisely captures the requirements that must be met to determine a fair return. All three requirements must be met and no one requirement takes precedence over the other two."*[6]

See the response to Request for Information PUB-NP-084 for further detail on the impact of different returns on equity and capital structures could have on the Company's credit ratings and the ability to issue First Mortgage Bonds.

[6] See Order No. P.U. 18 (2016), page 10, line 44 to page 11, line 4.